

May 4, 2005



Audit Oversight

DoD Hotline Allegations Concerning
Postaward Audits at the Defense
Contract Audit Agency Boeing
Huntington Beach Resident Office
(D-2005-6-005)

Department of Defense
Office of the Inspector General

Quality

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Accountability

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MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY

**SUBJECT: DoD Hotline Allegations Concerning Postaward Audits at the
Defense Contract Audit Agency, Boeing Huntington Beach Resident
Office (Report No. D-2005-6-005)**

I. INTRODUCTION

We initiated this evaluation in response to a DoD Hotline alleging that management¹ at the Defense Contract Audit Agency (DCAA), Boeing Huntington Beach Resident Office² (Resident Office) did not properly address contractor fraud referrals in accordance with DCAA policies and procedures. The complainant's main allegations are:

- An auditor submitted a draft fraud referral to the Resident Office management as a result of findings identified during a postaward audit completed in FY 1999. Management did not issue the fraud referral and gave no reason, orally or in writing, as to why it was not forwarded to DCAA headquarters.
- A DCAA Western Regional Audit Manager (RAM) directed an auditor to erase all evidence of a draft fraud referral from an audit working paper file for a postaward audit performed in FY 2002. Resident Office management also instructed another auditor to ensure the audit produced no findings. In addition, Resident Office management closed the audit by issuing an Memorandum for Record (MFR) instead of an audit report.
- Resident Office management forced an auditor to issue a negative audit report for a postaward audit that disclosed findings.
- Resident Office management did not select any pricing actions for postaward audit in FY 2003.

¹ Management includes the Regional Audit Manager (GS-15), the Resident Auditor (GS-14), and the supervisory auditor (GS-13) at the Boeing Huntington Beach Resident Office.

² A resident office is a DCAA field audit office located at a contractor's facility for the purpose of performing the contract audit workload.

II. SUMMARY

Review Findings. We partially substantiated one of four allegations (Allegation 2) and could not evaluate one allegation because the audit working paper file could not be located (Allegation 1). We did not substantiate the other two allegations (Allegations 3 and 4).

The Resident Office did, in fact, close an audit with an MFR as opposed to issuing an audit report. The Resident Auditor³ stated that she directed the supervisor to write an MFR to document in the audit file that the Procuring Contracting Officer (PCO) would not support the audit findings because the PCO believed that the cost and pricing data had been provided but not used during negotiations. However, the Resident Auditor did not intend for the MFR to be written instead of an audit report. The Resident Auditor further stated that the supervisor should have known that an audit report had to be issued. By not issuing an audit report for this postaward audit, the Resident Office failed to comply with DCAA policies and procedures that require issuing an audit report for all postaward audits with or without findings. The Resident Auditor should obtain a confirmation from the PCO on whether accurate, complete, and current data were disclosed to the PCO and whether the data were relied on. Based on the PCO response, the Resident Office should then determine whether defective pricing exists and issue an audit report to the National Aeronautics and Space Administration (NASA).

Section V, “Other Findings to be Reported,” of this report discusses other issues related to the allegations such as the loss of the audit working paper file, filing of unissued draft fraud referrals, and closing postaward audits without an audit report. DCAA should either revise the existing guidance to specify where the audit office manager’s memorandum and the draft fraud referral should be filed or issue a memorandum clarifying the existing guidance and revise the DCAA Management Information System (DMIS) to allow defective pricing audit assignments to only be closed by issuing an audit report or canceling the assignment.

III. BACKGROUND

Truth in Negotiations Act. The Truth in Negotiations Act (TINA), under Section 2306a of Title 10, United States Code, requires contractors to submit current, accurate, and complete cost or pricing data⁴ when negotiating contracts with the Government.

³ A Resident Auditor is a field audit office manager.

⁴ Cost or pricing data are all the facts at the date of price agreement that prudent buyers and sellers would reasonably expect to affect price negotiations significantly.

TINA also provides a price reduction remedy when a contractor fails to submit current, accurate, and complete data and the Government relied on the defective data in determining the contract price. The remedy includes provisions for interest and penalties.

DCAA performs postaward audits, also known as defective pricing audits, to determine whether a contractor complied with TINA. To show that defective pricing exists, the audit must establish five points.

- The information in question fits the definition of cost or pricing data.
- Current, accurate, and complete data existed and were reasonably available to the contractor before the agreement on price.
- The contractor did not submit or disclose the current, accurate, and complete data to the contracting officer or an authorized representative and these individuals did not have actual knowledge of such data or its significance to the proposal.
- The Government relied on the defective data in negotiating with the contractor.
- The Government's reliance on the defective data caused an increase in the contract price.

See the Appendix A for the scope and methodology of the review.

IV. FINDINGS AND CONCLUSIONS REGARDING ALLEGATIONS

Allegation 1. An auditor submitted a draft fraud referral to the Resident Office management as a result of findings identified during a postaward audit [Audit Assignment Number (No.) 4461-1999A42000005] completed in FY 1999. Management did not issue the fraud referral and gave no reason, orally or in writing, as to why it was not forwarded to DCAA headquarters in violation of DCAA Instruction (DCAAI) No. 7640.16, "Reporting Suspected Contractor Fraud and Other Contractor Irregularities." The allegation could not be evaluated.

Facts and Analysis:

Lost Audit Working Paper File. The DCAA Resident Office could not locate the audit working paper file for Assignment No. 4461-1999A42000005, "Postaward Audit of Cost or Pricing Data for STAR 37 FM Upper Stage Delta Usage on Stardust, Deep Space 1, and IMAGE Missions under Contract Number NAS5-32933." They did provide a copy of the September 30, 1999, audit report and some extraneous "unofficial" working papers.

The “unofficial” working papers, however, do not represent a complete audit working paper file. The auditors charged 733 hours to the assignment, and DCAA billed NASA approximately \$65,482 for the audit.

Audit Results. The audit report recommended a total price adjustment of \$647,903. The report attributed the Recommended Price Adjustment (RPA) to overstated subcontract and material costs, the associated indirect expenses, and related contractor profit. The PCO sustained the RPA in April 2002.

Subcontract Costs. The “unofficial” working papers contained a letter dated prior to the date of price agreement in which a subcontractor clearly informed the prime contractor that they had reduced the price of one specific motor. The prime contractor, however, did not update their proposal to reflect the price reduction. The prime contractor’s response contained in the audit report disagreed with the DCAA finding of defective pricing because the price for the one motor was included in a total proposed price for it and two other motors, and, therefore, had no individual visibility. The prime contractor also pointed out that the subcontractor’s updated proposal was higher than the original proposal. The letter referenced other documents that were not in the “unofficial” working papers provided, and, therefore, could not be evaluated.

Material Costs. The audit report stated that overstated material costs resulted from incorrect quantity pricing, obsolete pricing data, and overstated lot charges⁵. The auditor based the finding on a judgmental sample of 10 parts from the contractor’s bill of materials resulting in an RPA of \$401,730 for 3 parts. The contractor did not agree that they had overpriced two parts because of incorrect quantity pricing and overstated lot charges. However, they did agree that the one part was obsolete but did not agree with the auditor’s calculated RPA.

Draft Fraud Referral. The “unofficial” working papers did not contain a draft fraud referral; however, they did contain a written account of a discussion between the auditor and the supervisor addressing potential irregularities. Another “unofficial” working paper listed a standard audit step requiring the auditor to determine whether any findings of defective pricing required further pursuit or referral because the audit detected material errors, irregularities, abuse, or illegal acts. The auditor referenced a working paper to address the audit step; however, the referenced working paper was not in the “unofficial” working papers provided.

Conclusion: The allegation could not be evaluated. Based on the “unofficial” working papers and the audit report, we could not determine whether the auditor ever submitted a draft fraud referral to the Resident Office management or whether a fraud referral was

⁵ Lot charges are vendor charges for items such as set-up, lot acceptance, documentation, and other special testing or processing costs that occur when an order is processed.

warranted. Neither the audit report nor the “unofficial” working papers contained information that would indicate potential fraud. In addition, DCAA Western region management and the Resident Office management and audit staff still employed by DCAA had no knowledge or recollection of a draft fraud referral being submitted. Further, without the official working paper file, we could not determine whether the audit was performed in compliance with DCAA policies and procedures. The loss of the audit working paper file is addressed in the Section V.

Allegation 2. A DCAA Western region RAM directed an auditor to erase all evidence of a draft fraud referral from an audit working paper file for a postaward audit performed in FY 2002 (Assignment No. 4461-2002A42000002). Resident Office management also instructed another auditor to ensure that the audit produced no findings. In addition, Resident Office management closed the audit by issuing an MFR instead of an audit report in noncompliance with DCAA policies and procedures. The allegation was partially substantiated.

Facts and Analysis:

Audit Assignment Information. The Resident Office established Assignment No. 4461-2002A42000002 to perform a postaward audit of cost or pricing data on Contract Number NAS5-30722, Modification No. 336. The audit file contained an MFR dated January 16, 2003. The auditors charged 800 hours to the assignment, and DCAA billed NASA approximately \$85,921 for the audit work.

Audit Results. The auditor determined that for two of five task numbers, the contractor had proposed costs higher than the actual costs incurred prior to negotiations as contained in cost reports provided to DCAA by the contractor. The auditor documented that the contractor stated that the Integrated Cost History System cost reports given to DCAA would have been available before price negotiation. In total, the auditor calculated an RPA of \$1,585,032 that included the overstated costs of \$1,410,393 and the associated profit.

Updated Actual Incurred Costs. The audit working papers contained documentation from the contractor as to what updated actual incurred cost information they provided to NASA prior to or during negotiations. In meeting notes, a contractor representative documented that they could not find any record that actual incurred costs through December 1999 were submitted to the PCO. However, the working papers also contained a letter from the contractor to the auditor stating that the contractor did provide actual incurred costs through October 1999 to the PCO prior to negotiations.

Supervisory Review. Based on a review of the audit working paper file and the draft audit report, the supervisor provided final review comments that required both the original auditor and another auditor to make edits to the draft report and complete the working papers. In addition, the supervisor noted that the hours charged to the assignment were excessively over budget.

Resident Auditor Review. Neither the audit working paper file nor the draft report contained any evidence that the Resident Auditor had reviewed either prior to RAM review.

Initial RAM Review and Guidance. The audit working paper file contained an e-mail from the RAM documenting their review of the audit working paper file. The RAM pointed out that the auditor needed to obtain and document additional information to substantiate the finding and prove defective pricing. Specifically, the auditor needed to name the report in which the actual incurred costs were available, when the report was available to contractor personnel, and to whom it was available. The RAM also had other concerns about the verbiage in the draft audit report and the working papers and in supervisory sign offs. In addition, the RAM noted that the hours incurred on the assignment were excessive. Finally, the RAM stated that the summary working paper contained a reference to a fraud referral that should not be in the working papers because the basis for the referral was not clear.

RAM Follow-up Review. The RAM performed a second review of the audit working paper files and subsequently sent an e-mail to the Resident Auditor concerning her issues with the audit work. The RAM stated that before the report could be issued it must be revised to clearly state the basis for defective pricing. The RAM repeated a prior concern that the audit report specify the contractor cost report available at the time of price negotiation that contained the actual incurred costs and who had access to it. The RAM also noted that the auditor changed the summary working paper but did not change the draft audit report to include this data.

Subsequent Actions. The audit working paper file contained an e-mail from the Resident Auditor to the supervisor and auditor documenting her review of the audit file and draft report. The Resident Auditor had several notes regarding the report and the working papers. She reiterated the repeated concern of the RAM that the audit report should specify the name of the cost report containing the actual incurred cost, when the cost report was available, and to whom it was available. The original auditor responded by questioning whether more information was needed from the contractor.

The Resident Auditor replied that the working papers had the information and nothing more was needed from the contractor. The supervisor and both auditors⁶ made the edits and revisions as set forth.

Auditor Actions to Resolve Open Issues. The second auditor who assumed responsibility for the audit from the original auditor sent e-mails to the contractor requesting information regarding the actual incurred costs and clarification on the accounts that were used to accumulate incurred costs. The working papers do not contain any documentation to indicate that the contractor responded to the auditor's request for actual incurred costs. However, the first issue involving a request was resolved when the Information Technical Specialist at the Resident Office pulled the information from the contractor's system and provided it to the second auditor. Secondly the auditor had asked whether the contractor was aware of an error that would be reported as a part of the RPA. The auditor did not require a response to develop the audit position.

Communication With the PCO. The auditor also attempted to obtain information from the PCO concerning the contractor's updated actual incurred cost information. The auditor sent an e-mail to the PCO with several questions regarding the actual incurred costs. In one question the auditor asked the PCO whether the contractor updated incurred costs through December 1999, before or during negotiations. In a subsequent e-mail, the auditor sent the draft RPA to the PCO and asked whether actual incurred costs would have made a difference in the negotiations and, if so, would the price be lower. The auditor sent a follow-up e-mail and left voice messages asking when the PCO would review the findings and provide responses to the questions. In a subsequent phone conversation, the PCO stated that she needed to talk with her boss about the issues. The PCO later sent an e-mail to the auditor stating she was not disagreeing or agreeing with the auditor and that she negotiated on a bottom line basis using technical input on labor hours and material dollars. The auditor and supervisor called the PCO to clarify her response and asked the PCO whether she would support the DCAA findings and the RPA. The PCO responded that she would have to talk to the technical person and get back to them. The PCO later informed the auditor that the Government had the correct information from the contractor at the time of negotiation but did not take advantage of it then, and she did not think they should take advantage of it now. Further, the Government negotiated the contract at the bottom line. The auditor then requested an e-mail from the PCO documenting the response, but the PCO stated that she was too busy to do so.

⁶ Two auditors worked on this audit. The original auditor was a technical specialist (GS-13) and the auditor who later assumed responsibility for the audit after the fieldwork was completed was a senior auditor (GS-12).

Final Management Guidance. The auditor documented on a supervisory guidance working paper that the Resident Auditor and supervisor stated that the auditor needed to document the position of the PCO and close the audit with an MFR.

Issuance of MFR. The supervisor documented that the audit was closed with an MFR because the PCO notified the auditor that she would not support the audit-determined RPA. At an exit conference, the auditor informed the contractor that, based on a discussion with the PCO, they were dropping the issues and closing the audit with an MFR. The auditor drafted the MFR that was subsequently signed by the supervisor for the Resident Auditor on January 16, 2003, and placed it in the audit working paper file. No audit report was issued. The MFR stated that the contractor proposed overstated incurred costs resulting in an RPA of \$1,410,393. In addition, the MFR also documented the position of the PCO. Finally, the MFR concluded that since the PCO would not support the RPA, the assignment would be closed with no further effort.

Draft Fraud Referral. No one involved with the audit who is still a DCAA employee remembered seeing a draft fraud referral. However, the DoD Hotline provided us a copy of a draft fraud referral with the complaint. The RAM stated that she never saw a draft fraud referral, only the reference to one in the summary working paper. The Resident Auditor stated that, to the best of her knowledge, a draft fraud referral was never submitted for review. During an interview, the second auditor stated that she never saw a draft fraud referral but had had conversations with another auditor who spoke of potential contractor irregularities. However, the second auditor did not believe the findings warranted a fraud referral. To the best of the second auditor's knowledge, no one drafted a fraud referral to submit to the Resident Office management.

Reporting Results of Postaward Audits. The DCAA Manual (DCAAM) 7640.1, "DCAA's Policies and Procedures," chapter 14-123, "Reporting Results of Audit (Postaward)," requires that DCAA issue an audit report for all postaward audits. When DCAA finds defective pricing during a postaward audit, they issue a positive audit report with an RPA. When the audit does not identify defective pricing, DCAA is to issue a negative audit report.

Quality Control Procedures. The "RAMB-4 Quality Control Program and Audit Report Sampling," dated July 23, 2003, requires RAM pre-issuance review and approval of positive defective pricing audits. In addition, the RAM is required to review at least one negative defective pricing audit per year.

In accordance with the quality control program, the RAM performed an initial review of this assignment because the draft audit report was positive. For this particular audit, the working paper file was not returned to her for follow-up review because a positive defective pricing report was not issued and was not selected for quality control review.

RAM Rebuttal. The RAM informed us that the original auditor had performance problems and did not adequately support defective pricing in the audits she reviewed. In this audit and one other assignment subject to her review, she requested that additional evidential matter be obtained to support audit conclusions that the contractor did not comply with TINA. The RAM subsequently provided copies to us of the performance appraisals for the supervisor and auditor who performed on this audit documenting identified deficiencies in their work performance. The original auditor, who has since retired, received a minimally successful rating for the performance period. The appraisal specifically characterized the work on this audit by stating that the working paper detail was insufficient to support the findings. The performance appraisal for the supervisor, who has also retired, addressed problems with supervision of staff, planning of audits, and review of audits.

Resident Auditor Rebuttal. The Resident Auditor stated that she did instruct the supervisor and auditor to explain the position of the PCO in an MFR; however, she did not intend for an audit report not to be issued. The Resident Auditor also stated that she did not know that an audit report was not issued because she only signs out defective pricing audit reports that are positive with findings. The Resident Auditor delegated authority to the supervisory auditor to sign and transmit negative defective pricing reports.

Supervisory Auditor Rebuttal. The supervisor who performed on this audit retired from DCAA. The Resident Auditor contacted the retired supervisor to see whether he would agree to be interviewed regarding the audit in question. The retired supervisor declined to talk with us.

Reporting Fraud and Other Irregularities. During any DCAA audit, the auditor is to be alert for any indicators of fraud or other irregularities that would warrant a referral. DCAAM 7640.1, chapter 14-121.2, “Examples of Conditions Warranting Consideration of a Fraud Referral,” provides examples specific to postaward audits of conditions when an auditor might make a fraud referral. DCAA also has specific procedures to be followed when this occurs that are set forth in DCAAI No. 7640.16, “Reporting Suspected Contractor Fraud and Other Contractor Irregularities,” and DCAAM, chapter 4-702.4, “Procedures for Referring Suspensions.” When an auditor suspects fraud, corruption, or unlawful activity, they are to draft a fraud referral.

The draft fraud referral is then submitted to the supervisor who determines whether the referral is sufficiently supported. When the supervisor determines that the draft referral is sufficiently supported, then the supervisor forwards the draft fraud referral to management for review. Once management determines the referral is supported, the draft fraud referral is sent to DCAA headquarters. When management decides that a referral is not warranted, they are to document this in a memorandum, provide copies to the supervisor and the originator, and file it with the draft fraud referral.

Conclusion: The allegation was partially substantiated. The Resident Office closed the audit with an MFR instead of issuing an audit report in noncompliance with DCAAM, chapter 14-123, "Reporting Results of Audit (Postaward)," which requires DCAA to issue an audit report for all postaward audits. The audit working paper file for Assignment No. 4461-2002A42000002 contained no evidence that Resident Office management instructed the auditor to ensure that there were no findings. Rather, the Resident Auditor and supervisor instructed the original auditor to document the position of the PCO with an MFR and close the audit. Resident Office management failed to ensure that the audit was properly closed and that an audit report was issued.

The RAM did instruct the original auditor to remove a reference to a fraud referral from the summary working paper. However, based on the content of the audit working paper file and discussions with Western region management and Resident Office management and auditors, no evidence existed at DCAA that either auditor submitted a draft fraud referral to the Resident Office management. The DoD Hotline did provide us a copy of a draft fraud referral with the Hotline complaint. Based on a review of the audit working papers, the audit report, and the draft fraud referral provided with the DoD Hotline complaint, we determined that the audit findings did not warrant a fraud referral.

Management Comment on Finding. The DCAA response to a draft of this report pointed out an error in the draft report section entitled "Initial RAM Review and Guidance." The first sentence should have stated that the e-mail from the RAM documented the Resident Auditor's review of the audit.

APO Response. We corrected the wording in the section (Page 6).

Recommendation:

We recommend that the Resident Auditor, Boeing Huntington Beach Resident Office, on Audit Assignment Number 4461-2002A42000002, obtain a written confirmation from the PCO on whether accurate, complete, and current data were disclosed to the PCO and whether the data were relied on. Based on the response of the PCO, the Resident Office should determine

whether defective pricing exists and issue an audit report to the National Aeronautics and Space Administration.

Management Comments. DCAA concurred with the recommendation and the audit office estimated that a final report will be issued by May 30, 2005.

Allegation 3. The Resident Office management forced an auditor to issue a negative audit report for a postaward audit that disclosed findings, which is in noncompliance with DCAA policies and procedures. The allegation was not substantiated.

Facts and Analysis:

Audit Assignment Information. The Resident Office established Assignment No. 4461-2001A42000005 to perform a postaward audit of cost or pricing data under Contract No. NAS5-30722, Modification 311, “2001 Mars Odyssey Mission Peculiar Activities.” The supervisor signed out a negative audit report for the Resident Auditor on October 17, 2002. The auditor charged 513 hours to this assignment, and DCAA billed NASA approximately \$54,605.

Results of Audit. The auditor determined that the contractor had defectively priced recurring lot charges based on a judgmental sample of six parts all with substantial recurring lot charges. The defectively priced recurring lot charges occurred because the contractor had both overstated recurring lot charges and had proposed recurring lot charges not applicable to the contract. The audit reported an RPA of \$71,176.

Overstated Recurring Lot Charges. The auditor disagreed with the contractor’s method of allocating recurring lot charges on the contract. The contractor allocated recurring lot charges to purchase orders using a line item allocation base (number of line items on each purchase order). The auditor determined that the contractor should have allocated recurring lot charges to the purchase orders by using the number of total parts ordered. In response to the draft finding, the contractor commented that the difference between their proposed recurring lot charges and the recurring lot charges calculated by the auditor was the result of a difference in estimating methodology. The auditor argued that the contractor normally allocated the recurring lot charges based on the total number of parts procured, not based on the number of line items bought. The auditor documented in the audit working paper file that the proposed cost was defective because the contractor did not follow their estimating policies and procedures, thus resulting in increased costs to the Government.

Recurring Lot Charges Not Applicable to Contract. The auditor concluded that recurring lot charges were included for one part that was not associated with the proposal. The contractor did not agree with the auditor and argued that the part was used on three different proposals and the proposed recurring lot charges were calculated based on this.

Supervisory Review. The supervisor reviewed the audit working paper file and documented several edits that needed to be made to the draft audit report. In addition, the supervisor documented actions that the auditor needed to take regarding unfinished working papers and a discrepancy in the hours incurred as documented in the working papers and the hours showing in DMIS. However, the supervisor did not document any issues or concerns with the actual audit findings and the RPA in the audit working paper file.

Resident Auditor Review. The Resident Auditor did not document any final review of the working papers or the draft audit report in the audit working paper file. However, on the interim guidance working paper, the auditor documented a discussion with the Resident Auditor about obtaining permission to review a variance factor. The supervisor signed off on this working paper.

RAM Review. The RAM provided an e-mail documenting her review that was not in the audit working paper file. The RAM made the following points.

- A case for defective pricing did not exist because the contractor had disclosed the recurring lot charges and its basis for estimating the costs.
- The auditor was really taking exception to the contractor's estimating methodology.
- In order to have defective pricing, the auditor specifically needed to identify the data that existed at the time of negotiation that was not provided to the Government.

In addition, the RAM determined that the hours charged to the assignment were excessive. As discussed in the previous allegation (Allegation 2), Resident Office management documented the identified deficiencies in the auditor's and supervisor's performance in their appraisals for the period.

Resolution of RAM Concerns. The auditor noted on the summary working paper that Resident Office management felt that to make a case for defective pricing, the auditor needed to specifically identify data that existed at the time of negotiation that were not provided to the Government. The auditor documented that they agreed that such data were not identified, and, therefore, no price adjustment was in order.

Conclusion. The allegation is not substantiated. No evidence existed suggesting that the auditor was forced to issue a negative audit report. Based on the documentation reviewed in the audit working paper file and interviews with DCAA Resident Office management, the auditor did not establish all of the elements needed to prove defective pricing. For instance, the contractor had proposed the recurring lot charges in accordance with their disclosed material estimating methodology. The auditor took issue with the contractor's estimating methodology and, therefore, did not have any support for defective pricing. The auditor should have handled this concern by drafting an audit lead for a future estimating system review or a flash estimating system report. The RAM agreed that the estimating system issue should have been addressed. A review of the Internal Control Audit Planning Summary for the contractor's estimating system showed moderate risk in the area of cost development; therefore, reporting the estimating issue would more than likely not have affected the estimating system risk rating at this contractor.

Allegation 4. Resident Office management did not select any pricing actions for postaward audit in FY 2003 in noncompliance with DCAA Memorandum for Regional Directors (MRD) 02-OWD-041(R), "Fiscal Year 2003 Planning and Staff Allocation Documents," dated July 25, 2002. The allegation was not substantiated.

Facts and Analysis:

Resident Office FY 2003 Selection of Pricing Actions. For FY 2003, the Resident Office used the Postaward Audit Selection System (PASS) for two contractor entities. The auditor who performed the PASS updated the defective pricing universe through information obtained from the contractor. The Resident Office had rated the Boeing Huntington Beach contractor entity as a medium low risk for defective pricing. The FY 2003 defective pricing universe for the Boeing Huntington Beach contractor entity consisted of 46 pricing actions subject to TINA. Of the 46, the Resident Office had chosen 3 for postaward audit in the previous year, leaving 43 eligible pricing actions for selection in FY 2003. All eligible pricing actions were in the \$500,000 to less than \$10 million strata and were categorized as fixed price.⁷ The Resident Office had no mandatory selections required in this strata. The auditor selected one pricing action with the highest value for review in compliance with the PASS requirement to select one of every 60 pricing actions based on a medium low-risk contractor, fixed-price pricing actions, and the applicable dollar strata. The Resident Office performed the audit under

⁷ Fixed price includes fixed price, labor hour, time and material, and other similar actions where total price or elements thereof are negotiated at a fixed amount.

Assignment No. 4461-2003B42000005, “Postaward Audit of Contract Number F33657-01-C-2002, Modification P00006,” and the audit did not identify any defective pricing.

Postaward Audit Selection System. The DCAA MRD 02-OWD-041(R), “Fiscal Year 2003 Planning and Staff Allocation Documents,” dated July 25, 2002, provided each audit office guidance on planning defective pricing audits through the use of PASS. The guidance requires each audit office to develop and maintain a universe of eligible contracts from which pricing actions are selected. The audit office uses the PASS to gauge potential risk of defective pricing by evaluating the factors that contribute the most to the risk. The factors include the rate of positive occurrences of defective pricing, the total amount of RPAs, and the results of audits on the contractor’s estimating and accounting systems. The audit office assigns each factor a weight of one, two, three, or four based on certain criteria established for each factor. One designates the lowest risk, and four is the highest risk rating. The average of the four factors’ ratings becomes the overall risk rating.

The PASS Matrix also separates the eligible pricing actions into various dollar value strata and contract type. The PASS Matrix then uses the three criteria (overall contractor risk rating, contract type, and dollar value strata) to determine how many pricing actions the audit office is required to select for review. The audit office selects the required number of audits by contract type and dollar value strata. The PASS Matrix designates pricing actions for certain contract types and dollar values as being mandatory. In addition, when the audit office has received a request to review a specific pricing action or has a “hard” audit lead on a pricing action, DCAA guidance considers them mandatory. Mandatory pricing actions are first used to satisfy the required number of audits. The audit office fulfills any remaining requirement by selecting additional pricing actions in the appropriate contract type and dollar value strata.

Conclusion: The allegation is not substantiated. The Resident Office properly implemented the PASS for FY 2003 for the Boeing Huntington Beach contractor. The PASS required that one pricing action be selected for postaward audit. The auditor selected one and the Resident Office performed an audit on the selected pricing action.

V. Other Findings to be Reported

Issue One: Loss of Audit Working Paper Files

The DCAA Resident Office could not locate the audit working paper files for two of eight postaward audits selected for review. One audit, Assignment No. 4461-1999A42000005, was named in the first allegation related to management ignoring a draft fraud referral. The other, Assignment No. 4461-2000A42000004, was judgmentally selected for review.

Loss of Assignment No. 4461-1999A42000005. The Resident Office found some extraneous “unofficial” working papers on floppy discs that were made available for review. Due to the loss of the official audit file, all auditors at the Resident Office signed a “Status of Working Paper Files” certification documenting any knowledge they may have of the whereabouts of the working papers or what happened to them. The Resident Office personnel provided no additional information. The auditor charged 733 hours to this assignment, and DCAA billed NASA approximately \$65,482. Because the Resident Office could not provide the official audit working paper file, we could not evaluate the working papers. Therefore, we could not determine the validity of Allegation 1 as previously discussed in this report.

Loss of Assignment No. 4461-2000A42000004. The Resident Office also could not locate the official audit working paper file for Assignment No. 4461-2000A42000004, “Postaward Audit of Contract Number NAS5-30722,” that was judgmentally selected for review. In this case, the Resident Office could not even produce a copy of the final audit report. All auditors at the Resident Office signed a “Status of Working Paper Files” certification documenting any knowledge they may have of the whereabouts of the original working papers or what happened to them. No one provided any additional information. The auditors charged 402 hours to this audit and DMIS showed that a report was issued on September 29, 2000. DCAA billed NASA approximately \$37,535 for the audit. The current Resident Auditor at the Boeing Huntington Beach Branch Office unsuccessfully attempted to obtain a copy of the report from NASA. The Resident Auditor, supervisor, and auditor who performed the review each provided written statements as to their recollection of the audit; however, none could recall details about the nature of the assignment or what work was performed.

Unofficial Files Subsequently Found. The former Resident Auditor found some “unofficial” electronic working papers for Assignment No. 4461-2000A42000004 on a compact disk 10 months after the audit working papers were originally requested.

The “unofficial” working papers did not constitute a complete audit working paper file; therefore, they could not be evaluated for compliance with DCAA policies and procedures. However, the “unofficial” working papers did contain a copy of a draft audit report dated September 29, 2000.

Western Region Quality Assurance Reviews. The Western Region Quality Assurance Division (WRQA) performed two reviews on audit working paper file storage in the Western region. Project Report No. 4011-2001H55200508, “Report on Storage and Backup of Final Electronic Working Papers,” was issued on April 18, 2001. The WRQA visited 15 audit offices and reviewed 97 completed audits and found that all offices had written procedures describing their electronic storage processes and responsibilities and had implemented those procedures. However, the report contained recommendations on how the audit offices could enhance their written procedures. Project Report No. 4011-2002H55200512, “Storage of Final Audit Working Papers,” was issued on September 27, 2002. The WRQA reviewed written closing action operating procedures for 16 audit offices. At 15 audit offices, they reviewed 67 assignments that were closed with a report issued in June 2002. The WRQA found that although all audit offices had written procedures regarding final working paper storage, over one half had not updated their procedures for revisions made to the July 2001 DCAAM guidance. As a result, WRQA recommended that the audit offices update their written procedures on final working paper closing actions to be fully compliant with the current requirements. The report also recommended that controls be established to ensure procedures are updated on a timely basis and that updated procedures be discussed with audit office staff. Neither report discussed any cases of missing electronic working papers.

Requirements When Files Are Destroyed or Lost. DCAAM 5015.1, “Files Maintenance and Disposition Manual,” updated March 20, 2001, requires in chapter 4, part C, “Accidental Destruction of Files,” that in cases of accidental loss or destruction of temporary or permanent files by fire or other causes, certain actions be taken. The audit office should:

- reconstruct as much of the lost or destroyed files as possible; or
- identify any lost or destroyed records that could not be reconstructed on the appropriate records retirement list at the time of retirement of records of the same date period to the records center. Along with the description of the records, an explanatory note regarding the accidental disposal of the records will be included; and
- report all accidental or unauthorized disposal of records to the DCAA Records Administrator, who in turn must notify the National Archives and Records Administration as prescribed by 36 Code of Federal Regulation 1228.104.

Current DCAA Guidance on Files Management. The Resident Office has its own standard operating procedure for records management, “Backup of Permanent Working Paper Files,” dated June 30, 2003. The Resident Auditor also stated they follow chapter 5 of DCAAM 5015.1, “Files Maintenance and Disposition Manual;” DCAAR 5015.2, “Records Management Program;” and Western Region Instruction No. 5015.1, “Records Management Program.” More recently, DCAA implemented the Integrated Reported Information Management System (iRIMS) in order to further facilitate a transition to a paperless environment. Copies of all electronic audit working paper files are required to be saved in iRIMS. In addition, as a result of discussions with DCAA headquarters during the review, DCAA issued MRD 04-CM-072(R), “Protecting Federal Records and Employees’ Recordkeeping Responsibilities,” dated December 21, 2004, reminding audit offices of the records management requirements associated with lost or destroyed files.

Subsequent Resident Office Action. The Resident Office issued a memorandum to the Director, DCAA, dated January 18, 2005, reporting the loss of Assignment Numbers 4461-1999A42000005 and 4461-2000A42000004 in accordance with DCAAM 5015.1. The Resident Office also implemented several processes to ensure that files are being maintained properly. The Resident Office now is to conduct a monthly reconciliation of audits dispositioned in DMIS to audits filed in iRIMS, and has instituted a new process for storing and retrieving the hardcopy working paper files.

Conclusion. The Boeing Huntington Beach Resident Office lost the “official” audit working paper files for two of eight postaward audits selected for review. The audits were performed in FYs 1999 and 2000, respectively. Since that time, DCAA has issued numerous policies and procedures on retaining and archiving audit working paper files, emphasizing electronic files. DCAA policies and procedures require each audit office to have strong controls in place to protect the integrity of the electronic and hard copy official files and their physical security. However, due to the recent implementation of iRIMS and new guidance on archiving electronic working papers, the emphasis of Western regional quality assurance reviews has been on the use and storage of electronic working papers. Limited attention has been given to testing proper retention of hard copy working papers that will continue to exist to some extent.

For audit assignment no. 4461-2000A42000004, no evidence exists that DCAA issued or that NASA received a final report. DCAA billed NASA approximately \$37,535 for the audit. Therefore, DCAA should coordinate with NASA to determine what additional actions that may be required.

Management Comment on Conclusion. The DCAA response disagreed with our conclusion that little emphasis had been placed on safeguarding hard copy working

papers. DCAA pointed out that the same policies on file retention apply to both hard copy and electronic files.

APO Response. We revised the conclusion paragraph to more accurately portray our conclusion. We added language to clarify that limited attention had been given to testing retention of hard copy files.

Revised Recommendation. As a result of management comments, we revised the Issue One Recommendation below to clarify that its intent was to have DCAA verify with NASA what, if any, additional action NASA believes is needed under the circumstances.

Recommendation:

We recommend that the Director, Defense Contract Audit Agency, coordinate with the appropriate National Aeronautics and Space Administration officials to determine what additional actions, if any, are required on audit assignment number 4461-2000A42000004, since there is no official audit working paper file and neither the Defense Contract Audit Agency nor the National Aeronautics and Space Administration have an official final audit report.

Management Comments. The DCAA nonconcurred with the draft recommendation. DCAA stated that no additional actions were needed because absent any conflicting evidence, sufficient evidence existed that a final audit report was issued. DCAA based their conclusion on DMIS showing that a final report with no audit exceptions was issued to NASA on September 29, 2000, and 402 hours charged to the audit. DCAA claimed that the DMIS information is supported by the unofficial draft report also dated September 29, 2000, to NASA with no exceptions that was found in unofficial audit working papers.

APO Response. The DCAA comments were not responsive. In the past, we have found inaccuracies in the DCAA management information system. Neither DCAA nor NASA has a copy of the final report. A former audit manager found the electronic unofficial draft report in a moving box from her former office approximately 10 months after we first requested it. Additionally, during the review, we identified another instance where the audit office did not issue a final audit report when no exceptions had been identified. Contrary to the DCAA position, they have no evidence that a report was ever formally issued. Therefore, DCAA should discuss the situation with NASA and determine what additional actions, if any, NASA requires to support its payment of over \$37,000 for a review that has no official audit files and no final report. DCAA should reconsider its comments to the revised Issue One Recommendation in response to the final report.

Issue Two: Filing of Memorandum and Draft Fraud Referral When Referral Determined to be Unnecessary

Resident Office Procedure for Retention of Draft Fraud Referrals. The Resident Office does not have an internal procedure in place as to where to file a draft referral and the required Resident Auditor's memorandum when the Resident Auditor determines that the referral should not be elevated to DCAA headquarters. The Resident Office management did not identify where such documents would be filed other than as part of the Resident Office administrative files because they had not had any draft fraud referrals that were determined to be unnecessary.

DCAA Policy on Issuing Fraud Referrals. DCAAI No. 7640.16 is very specific about the responsibilities of management when an auditor has detected suspected contractor fraud or other irregularities. When this occurs, the auditor submits a draft fraud referral to their supervisor providing the basis for why the auditor suspects fraud or other irregularities. The supervisor is required to review the draft fraud referral for information that suggests a reasonable basis for suspicion of fraud, corruption, or unlawful activity. When the supervisor decides that a reasonable basis exists, as documented in the referral, the supervisor must provide the draft fraud referral to the audit office manager for review and approval. The audit office manager must review the draft fraud referral and determine whether or not it should be forwarded to DCAA headquarters. DCAAI No. 7640.16, chapter 5.2.4 specifically directs the audit office manager to "...Document by memorandum reason(s) for any conclusion that there is not a sufficient basis for suspicion of fraud or other irregularity. Provide a copy of the memorandum to the supervisor and originator, and file the memorandum with the draft DCAA Fraud referral."

DCAA Headquarter Guidance. In a teleconference held on June 24, 2004, the DCAA Deputy Assistant Director for Operations stated that he did not see a problem with the memorandum and draft fraud referral being filed in the audit working paper file and that having these documents in the audit working paper file shows that fraud indicators were disclosed and considered. However, he also stated that additional research was needed to determine whether any guidance existed specifying where the documents should be filed. In a follow up e-mail, he referenced page 150 of DCAAM 5015.1, "Files Maintenance and Disposition Manual," updated March 20, 2001, as specifying the filing location. DCAAM 5015.1 provides, "...records related to Suspected Irregular Conduct referrals and responses to requests from investigative agencies or the Department of Justice regarding fraud or other irregular practices should be filed under code 850.3," which is part of the DCAA standard numbered filing system.

Conclusion. Current DCAA guidance does not specify where the required audit office manager’s memorandum and draft fraud referral should be filed. DCAAM 5015.1 does provide guidance for records related to fraud referrals. Because of the importance of these documents, DCAA should issue guidance clarifying and reminding the audit staff where the required audit office manager’s memorandum and the associated draft fraud referral should be kept. In addition, if DCAA expects these documents to be filed separately from the audit working paper file, then existing guidance may need to be strengthened to ensure that the auditor appropriately documents the consideration of fraud indicators in the audit working paper file as required by GAS.

Recommendation:

We recommend that the Director, Defense Contract Audit Agency, revise the existing guidance in Defense Contract Audit Agency Instruction No. 7640.16, “Reporting Suspected Contractor Fraud and Other Contractor Irregularities,” to specify that the draft fraud referral and the audit office manager’s memorandum that states why the referral was not forwarded should be filed under Code 850.3 or issue a memorandum clarifying the existing guidance.

Management Comments. DCAA concurred with the recommendation. By July 31, 2005, DCAA planned to issue guidance to the field on filing a draft fraud referral and the associated memorandum under Code 850.3 and referencing the working papers accordingly. DCAA will also revise DCAAI No. 7640.16 appropriately.

Issue Three: Postaward Audits Closed With No Audit Report Issued

Discussions with DCAA regarding Assignment No. 4461-2002A42000002 that was closed with an MFR instead of an audit report raised questions about when to use an MFR to close an assignment.

DCAA Headquarters Review. Based on our finding, DCAA headquarters decided to perform a review to determine the significance of the issue. Staff from Operations Workload Analysis Division (OWD) queried DMIS to determine how many postaward audits had been closed without a report in FYs 2003 and 2004. OWD found that a total of 119 audits were closed with no report, representing 7,995 audit hours. For FY 2003, DCAA closed 86 audits with 5,827 hours charged without a report. In FY 2004, DCAA closed 33 audits with 2,168 hours charged without a report.

Audits That Should Have Been Cancelled. As a result of the significance of the numbers retrieved from DMIS, OWD coordinated with the DCAA headquarters Policy Division. The Policy Division performed an analysis of postaward audits closed in DMIS with code “N – No Report” and learned that 35 percent were closed because the auditor discovered, after commencing the audit, that the pricing action was not based on certified cost or pricing data. The Policy Division concluded that it would have been more appropriate to close these audits with code “C – Cancelled.”

Audits That Could Be Closed With No Report. The Policy Division determined that the audit office could close an audit with no report issued only when the audit was to assist another office cognizant over a subcontractor or different contractor division.

Planned DCAA Guidance. DCAA plans to issue guidance in the form of an MRD to:

- ensure that offices, to the extent practical, program pricing actions that are subject to TINA;
- remind auditors that the preliminary audit steps are to brief the contract and Price Negotiation Memorandum to reconfirm that the pricing action is a negotiated procurement, has not been audited before, includes the defective pricing clause, and that the Government relied on the cost or pricing data provided by the contractor;
- clarify that postaward audits should be closed in DMIS with Code “C – Cancelled” when it has been determined a postaward audit will not be conducted;

Conclusion. DCAA headquarters staff identified, analyzed, and proposed corrective actions for a significant issue. However, we do not agree that appropriate situations exist for defective pricing audit assignments to be closed in DMIS with a “no report” designation. DCAA should either issue an audit report or cancel the audit. When an audit office is only gathering information for another office and a defective pricing audit is not being performed on an assist basis, then the audit office could charge the hours to a blanket DMIS code established for this purpose. The planned guidance also should include a reminder that any defective pricing audit that is canceled must be replaced in order to satisfy the requirements of the PASS. In addition, DCAA should notify NASA when DCAA has billed NASA for any cancelled defective pricing audits after incurring more than a minimum number of hours because TINA was not applicable.

Recommendation:

We recommend that the Director, Defense Contract Audit Agency:

- 1. revise Defense Contract Audit Agency Management Information System to only allow defective pricing audit assignments to be closed by issuing an audit report or canceling the assignment,**
- 2. issue guidance reminding the audit offices that any canceled defective pricing review must be replaced with a similar substitute in order to comply with the Postaward Audit Selection System requirements, and**
- 3. notify the National Aeronautics and Space Administration of any canceled defective pricing audits that were billed to them in FYs 2003 and 2004.**

Management Comments. DCAA concurred with Recommendations 1 and 2, but nonconcurred with Recommendation 3. DCAA agreed to revise, by September 30, 2005, the DMIS to only allow defective pricing audits to be closed when issuing a report (“R”) or canceling the audit (“C”). DCAA also agreed to issue, by July 31, 2005, a memorandum reminding the audit staff that when a programmed, discretionary defective pricing audit is canceled, then a substitute pricing action must be reviewed. The same memorandum will include a new requirement to notify the cognizant customer when a defective pricing audit is canceled. However, for Recommendation 3, DCAA stated that due to the minimum hours involved, it would not be economical to notify the cognizant customers which FYs 2003 and 2004 defective pricing audits were canceled.

APO Response. The DCAA comments for Recommendations 1 and 2 were responsive and for Recommendation 3 were not responsive. For Recommendation 3, DCAA has a fiduciary responsibility to formally notify the cognizant customer when a review has been canceled, especially when DCAA billed the customer for hours associated with the canceled work. Such a notification will allow the customer to determine whether it needs to take any action such as establishment of an added internal control, to prevent a future waste of its resources. Additionally, DCAA has already identified the pertinent assignments and hours; therefore, DCAA should not have to expend a significant amount of resources to perform the task. DCAA should reconsider its comments to Recommendation 3 in response to the final report.

We are providing this report for review and comment. We considered management comments on a draft of this report when preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Management comments were partially responsive. Based on management comments, we revised the draft report recommendation for Issue One, "Other Findings to be Reported." We request that DCAA provide additional comments on Issue One Recommendation and Issue Three, Recommendation 3 by May 20, 2005.

If possible, please provide management comments in electronic format (Adobe Acrobat file only). Send electronic transmissions to the e-mail address cited in the last paragraph of this memorandum. Copies of management comments must contain the actual signature of the authorizing official. We cannot accept the /Signed/ symbol in place of the signature.

We appreciate the courtesies extended to the staff. Questions on the review should be directed to Mr. Ted Van Why at (703) 604-8748 (evanwhy@dodig.osd.mil) or Ms. Diane H. Stetler at (703) 604-8737 (dstetler@dodig.osd.mil). See Appendix B for the report distribution.

A handwritten signature in black ink, appearing to read "Patricia A. Brannin". The signature is fluid and cursive, with a large initial "P" and "B".

Patricia A. Brannin
Assistant Inspector General
Audit Policy and Oversight

Appendix A: Scope and Methodology

To determine the validity of the allegations, we selected eight postaward audits for review, including the three audits named in the allegations. We judgmentally selected five other audits from 1999 through 2002 with a fair representation amongst the audit teams. We evaluated the official audit working paper files for six postaward audits. The Resident Office could not locate two of the requested eight audit working paper files including the FY 1999 audit named in the allegations. The other missing audit file was for an FY 2000 audit that was judgmentally selected for review. For those two audits, we reviewed “unofficial” working papers that were available. In addition, we interviewed DCAA managers and personnel. Specifically, we:

- determined the applicable professional auditing standards, laws (statutes), and DCAA policies and procedures;
- reviewed DMIS database for FYs 1999 through 2002 and judgmentally selected five postaward audits to evaluate in addition to the three named in the allegations;
- queried DMIS database to determine what postaward audits were initiated in FY 2003;
- evaluated six of the eight postaward audit working paper files selected for review to determine whether they were performed in accordance with DCAA policies and procedures;
- interviewed the RAM and the Resident Auditor who were assigned to the Resident Office at the time the audits were performed;
- interviewed the auditors who performed the audits, both current DCAA employees and retired employees;
- obtained a “Status of Working Paper Files” form from all DCAA personnel at the Resident Office and appropriate Western region management officials, including the Deputy Regional Director who was the prior RAM and the current RAM, certifying as to any knowledge they have of the two missing audit working paper files; and
- reviewed the defective pricing universe and pricing action selections for FY 2003 for the Boeing Huntington Beach contractor entity to determine whether the selections were made in accordance with policies and procedures as set forth in the DCAA PASS.

The supervisor who reviewed the audits named in the allegations was not available to be interviewed because he had retired. DCAA contacted him, but he declined to speak with us.

Appendix B: Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)/Chief Financial Officer

Other Defense Organizations

Director, Defense Contract Audit Agency
Regional Director, Western Region
Resident Auditor, Huntington Beach Resident Office

Non-Defense Federal Organization

Inspector General, National Aeronautics and Space Administration

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency and Financial Management, Committee on
Government Reform
House Subcommittee on National Security, Emerging Threats, and International Relations,
Committee on Government Reform
House Subcommittee on Technology, Information Policy, Intergovernmental Relations, and the
Census, Committee on Government Reform

Defense Contract Audit Agency Comments

Final Report
Reference



DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
8725 JOHN J. KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-6219

IN REPLY REFER TO

PQA 225.4[D2004-DIPOAC-0106]

April 11, 2005

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDIT POLICY AND
OVERSIGHT, OFFICE OF THE INSPECTOR GENERAL,
DEPARTMENT OF DEFENSE

SUBJECT: Response to Draft DoDIG Report on Evaluation of DoD Hotline Allegations
Regarding Postaward Audits at the Defense Contract Audit Agency, Boeing
Huntington Beach Resident Office, Project No. D2004-DIPOAC-0106

Thank you for the opportunity to comment on the subject draft report and the results of the evaluation reported therein. The DoDIG evaluation was performed in response to a DoD Hotline alleging that management at the DCAA Boeing Huntington Beach Resident Office did not properly address contractor fraud referrals in accordance with DCAA policies and procedures. Provided below are our comments clarifying certain statements and findings in the report. Following these comments is our response to the report recommendations.

A. Comments on Draft Report Narrative

1. DoDIG Report Section IV, Allegation 2, Initial RAM Review and Guidance, Page 6

DoDIG: The 1st sentence of this paragraph states the following:

The audit working paper file contained an e-mail from the RAM documenting the Resident Auditor's review of the audit working paper file.

DCAA Comment: We believe this statement should read as follows:

The audit working paper file contained an e-mail from the RAM documenting the RAM's review of the audit working paper file.

2. DoDIG Report Section V, Other Findings to be Reported, Issue One: Loss of Audit Working Paper Files, Conclusion, Page 17

DoDIG: The DoDIG concludes that because of the emphasis by DCAA on the use of electronic working papers, limited attention has been given to proper retention of hard copy working papers.

Revised

PQA 225.4[D2004-DIPOAC-0106]

April 11, 2005

SUBJECT: Response to Draft DoDIG Report on Evaluation of DoD Hotline Allegations
Regarding Postaward Audits at the Defense Contract Audit Agency, Boeing
Huntington Beach Resident Office, Project No. D2004-DIPOAC-0106

DCAA Comments: We disagree. Although the Agency has transitioned to a near “paperless” environment, hardcopy working paper files are still being maintained, e.g., when scanning is not practical. These and other DCAA files are safeguarded and protected in accordance with the same Agency record retention requirements (DCAAM 5015.1, Files Maintenance and Disposition Manual) as are used for electronic files. The DCAA Boeing Huntington Beach Field Audit Office procedures include an internal control process for storing and retrieving hardcopy working files.

3. DoDIG Report Section V, Other Findings to be Reported, Issue Three: Postaward Audits Closed With No Audit Report Issued, Planned Audit Guidance, Page 20

DoDIG: The draft report states the following:

Planned DCAA Guidance: DCAA plans to issue guidance in the form of an MRD to:

- Ensure the offices, to the extent practical, program pricing actions that are subject to TINA;
- Remind auditors that the preliminary audit steps are to brief the contract and Price Negotiation Memorandum to reconfirm that the pricing action is a negotiated procurement, has not been audited before, includes the defective pricing clause, and that the Government relied on the cost or pricing data provided by the contractor;
- Clarify that postaward audits should be closed in DMIS with Code “C- Canceled” when it has been determined a postaward audit will not be conducted;
- Establish a soft edit in DMIS that will remind the auditor of the DMIS code definitions and DCAAM 7640.1 requirements when closing a postaward audit; and
- Establish a DMIS query that may be used by regions and audit offices to monitor the codes for postaward audit closed with “N-No Report.”

DCAA Comments: Based on our agreement to implement the DoDIG recommendation to eliminate the option of dispositioning postaward audits using “Code N – No report issued,” our planned guidance identified above will not address the last two bullets, since they will no longer be applicable. See Item B.4. on page 4 for further information.

B. DCAA Response to DoDIG Recommendations

1. DoDIG Report Section IV, Allegation 2, Recommendation, Page 10

DoDIG: We recommend that the Resident Auditor, Boeing Huntington Beach Resident Office, on Audit Assignment No. 4461-2002A42000002, obtain a written confirmation

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from the PCO on whether accurate, complete, and current data were disclosed to the PCO and whether the data were relied on. Based on the response of the PCO, the Resident Office should determine whether defective pricing exists and issue an audit report to the National Aeronautics and Space Administration.

DCAA: Concur. The FAO coordinated with the PCO and is in the process of preparing a draft report with positive findings and scheduling an exit conference with the contractor to obtain the contractor's official response to the draft report findings. The FAO anticipates issuing an audit report no later than May 30, 2005.

2. DoDIG Report Section V, Other Findings to be Reported, Issue 1: Loss of Working Paper Files, Recommendation, Page 18

DoDIG: We recommend that the Director, Defense Contract Audit Agency, coordinate with the appropriate National Aeronautics and Space Administration officials to determine what additional actions must be taken to close-out assignment number 4461-2000A42000004.

DCAA Response: Nonconcur. We do not believe that any additional actions are required to close out the audit. DCAA policy requires that every audit assignment is entered and tracked in the DCAA Management Information System (DMIS). DMIS captures a complete history of individual audit assignments, including such events as the date established, hours charged by pay period, and date completed. Further, DMIS identifies whether an audit report was issued, whether there were reported audit exceptions, and if so, the dollar amount of the exceptions. All required audit assignment information was recorded in DMIS for Assignment Number 4461-2000A42000004 throughout FY 2002 in accordance with Agency policy. DMIS recorded that an audit report without audit exceptions was issued to NASA on September 29, 2000, and that 402 hours were charged to this assignment. This is further supported by the existence of a draft report in the unofficial working paper files that was dated September 29, 2000, was addressed to NASA, and that reported no audit exceptions. Absent any evidence to the contrary, we believe this is sufficient evidence that the audit report was issued.

3. DoDIG Report Section V, Other Findings to be Reported, Issue 2: Filing of Memorandum and Draft Fraud Referral When Referral Determined to be Unnecessary, Recommendation, Page 19

DoDIG: We recommend that the Director, Defense Contract Audit Agency, revise the existing guidance in Defense Contract Audit Agency Instruction No. 7640.16, "Reporting Suspected Contractor Fraud and Other Contractor Irregularities," to specify that the draft fraud referral and the audit office manager's memorandum that states why the referral

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was not forwarded should be filed under Code 850.3 or issue a memorandum clarifying the existing guidance.

DCAA Response: Concur. By July 31, 2005, DCAA will issue a Memorandum for Regional Directors requiring field audit office managers to file under DCAA file code 850.3 (Suspected Irregular Conduct) any draft fraud referrals and the related FAO manager memorandum documenting their disposition of the referral. We will also revise DCAAI No. 7640.16 to incorporate this requirement. The MRD will also clarify existing guidance requiring auditors to place a reference in the working papers to any fraud referral if the referral originated from a specific audit (DCAAM 4-702.4).

4. DoDIG Report Section V, Other Findings to be Reported, Issue 3: Postaward Audits Closed With No Audit Report Issued, Recommendation (Page 21).

DoDIG: We recommend the Director, Defense Contract Audit Agency:

1. revise the Defense Contract Audit Agency Management Information System to only allow defective pricing audit assignments to be closed by issuing an audit report or canceling the assignment.
2. issue guidance reminding the audit offices that any canceled defective pricing review must be replaced with a similar substitute in order to comply with the Postaward Audit Selection System Requirements, and
3. notify the National Aeronautics and Space Administration of any canceled defective pricing audit that were billed to them in FYs 2003 and 2004.

DCAA Response: Concur with Recommendations 1 and 2. Nonconcur with Recommendation 3. Our comments by recommendation are as follows:

1. By September 30, 2005, DCAA will revise the Defense Contract Audit Agency Management Information System to only allow defective pricing audit assignments to be closed with a disposition code of "R" for when a report is issued or with a disposition code of "C" for when audits are canceled. DCAA policy requires that a postaward audit report be issued even when no defective pricing is found, therefore, our analysis concluded that the disposition code for closing an assignment when no report is issued (i.e., Code N) is no longer applicable for postaward audits.
2. By July 31, 2005, DCAA will issue a Memorandum for Regional Directors (MRD) providing audit guidance to require auditors to select another contract pricing action for postaward audit when a programmed postaward audit has been started and then subsequently canceled. This new guidance would apply to discretionary (i.e., not

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mandatory) assignments. In addition, we plan to include in this MRD new audit guidance requiring auditors to notify the cognizant customer when a postaward audit is announced and then subsequently canceled.

3. As stated in the above paragraph, we plan to issue new guidance requiring auditors to notify the cognizant customer when a postaward audit is canceled after having been announced. We believe these actions represent a good future business practice. However, we do not agree it would be an efficient use of Government resources to notify NASA of postaward audits we canceled in FY 2003 and FY 2004. Our review disclosed that there were 8 assignments canceled in this time period, incurring an average of 17 hours per assignment. Due to the minimum number of hours incurred and the time lapse since some of these assignments were canceled (e.g., over 2 years ago), we do not believe it would be a prudent use of Government resources to implement this recommendation.

Questions regarding this memorandum should be directed to Mr. Ken Saccoccia, Chief, Quality Assurance Division, at (703) 767-2298.

/Signed/
Robert DiMucci
Assistant Director
Policy and Plans